

STATE OF HAWAII  
DEPARTMENT OF LAND AND NATURAL RESOURCES  
Land Division  
Honolulu, Hawaii 96813

March 24, 2011

Board of Land and Natural Resources  
State of Hawaii  
Honolulu, Hawaii

Ref: GL S-5844

Hawaii

Request to Reduce Performance Bond Requirement, General Lease No. S-5844,  
Hawaii Outdoor Tours, Inc., Lessee; Waiakea, South Hilo, Hawaii, Tax Map  
Keys: 3rd/ 2-1-1:12, 2-1-5:13, 16, 17, 27, 32 & 46

BACKGROUND:

General Lease No. S-5844 (Lease) was issued at public auction on September 30, 2005 to Hawaii Outdoor Tours, Inc. (Lessee) for a term of 65 years commencing on February 1, 2006. The Lease character of use is for hotel and golf course purposes. A map showing the location of the subject parcels is attached as Exhibit A.

The rent for the first ten years of the Lease is \$500,000 per annum or 2% of gross revenues, whichever is greater. To date, the reported percentage of gross revenues has not exceeded the base rent. Lessee also paid \$6,100,000 to the prior lessee to acquire the leasehold improvements. This purchase price was financed by a mortgage placed on the leasehold estate and improvements in favor of First Regional Bank and consented to by the Chairperson of the Board of Land and Natural Resources on January 20, 2006. First Citizens Bank subsequently took over First Regional Bank.<sup>1</sup>

Under the Lease, Lessee is required to post a performance bond equivalent to two times the annual rent. Currently, the required bond amount is \$1,000,000 and Lessee is in compliance by means of a savings deposit also at First Citizens Bank.

Recently, Lessee requested a meeting with Land Division staff to discuss the possibility of reducing the amount of the performance bond and applying the released portion of the bond to rent. Lessee explained that it does not have the financial capability at the present time to pay the semiannual rent installment in the amount of \$250,000 that was due on February 1, 2011. A notice of default for the unpaid rent was issued on February 28,

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<sup>1</sup> Under Hawaii Revised Statutes Section 171-22, the interest of an institutional mortgage holder is freely assignable.

2011 and received by Lessee on March 2, 2011. Lessee has 30 days to cure from the date of receipt. The default remains outstanding.

In Lessee's letter attached as Exhibit B, Lessee explains that Lessee intends to refinance its mortgage on the leasehold estate, but that the credit market has tightened and the financial institutions are reluctant to make long-term loans. Lessee further advises that Lessee's parent company, Ken Direction Corp. (KDC), owns approximately 1,951.05 acres of land near Hawaii Volcanoes National Park that is under contract for sale to the National Park Service as an addition to the park.<sup>2</sup> Lessee explains that this sale has been delayed due to Congress' non-approval of the federal budget. Additionally, a subsidiary of KDC owns approximately 31.44 acres in South Hilo (TMK: (3) 2-2-48:93) that is under contract for sale to a third party. The sale of those properties would improve KDC's and Lessee's cash position and help finance future construction phases at the hotel. Lessee is also anticipating an increase in tourism to East Hawaii due to the addition of new Continental/United Airlines flights from Los Angeles and San Francisco to Hilo commencing June 9, 2011. In the meantime, Lessee is seeking the subject performance bond reduction to pay its rent for one year.

REMARKS:

Paragraph 28 of the Lease provides for waiver or modification of the performance bond requirements upon substantial compliance by the Lessee of the terms, covenants and conditions of the Lease. It also reserves the right of the State to reactivate or reimpose the bond, if need be at any time throughout the Lease term.

Since the commencement of the Lease on February 1, 2006, the following notices of default have been issued to the Lessee:

February 28, 2011 – Failure to keep lease rental payments current  
August 23, 2010 – Failure to keep lease rental payments current  
August 23, 2010 – Failure to provide percentage rent report  
February 13, 2009 – Failure to keep lease rental payments current

As mentioned above, the February 28, 2011 rent default is outstanding with a cure deadline of April 1, 2011. The other defaults noted above were all timely cured.

The Lease at Paragraph 40 required Lessee to make at least \$5,000,000 in renovation improvements to the hotel by January 31, 2009. Staff conducted inspections of the hotel on February 13, 2007, April 16, 2008, June 27, 2008, and June 8, 2009 to assess the progress of the renovation work, and obtained documentary support from Lessee to confirm the expenditure of more than \$5,000,000 on hotel improvements by the January 31, 2009 deadline.

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<sup>2</sup> The Tax Map Keys for this land are: (3) 9-6-13:3, 7, 8, 9 & 10.

Most of the renovation work was done on the hotel's Mauna Kea Tower. When Lessee published a notice of completion as to that tower on July 7 and 14, 2010, a contractor filed an application for mechanic's and materialmen's lien and notice with the Third Circuit Court on August 30, 2010 naming Lessee, DLNR and others as respondents. The application sought \$80,361.79 in unpaid labor and material costs, plus interest, costs and reasonable attorneys' fees. DLNR was dismissed from the action with prejudice by stipulated order entered October 4, 2010. The Lessee and the contractor are now arbitrating their dispute. No mechanic's or materialmen's lien has attached to the leasehold improvements or the land.<sup>3</sup>

Staff has received complaints from the public about the condition of a parcel of private land adjoining the Lease premises, TMK: (3) 2-1-5:18 (Parcel 18). On the property are an abandoned restaurant, swimming pool and accessory structures. Lessee leases the land from the private owner for a term ending in 2015. Because Parcel 18 is private property, the Lease terms and conditions are inapplicable to it and staff has no legal basis to inspect the land or direct the Lessee to improve it.<sup>4</sup>

Upon application of \$500,000 of the performance bond to rent, if approved by the Board, Lessee would be in substantial compliance with the Lease. Accordingly, staff recommends the Board reduce the performance bond requirement from \$1,000,000 to \$500,000, which is equivalent to six months of rent. There is some benefit to the State in taking this action, as the State will receive the \$500,000 of released performance bond in the form of rent, \$250,000 of which would otherwise not be due until August 1, 2011.

Staff recommends the Board approve the request subject to the conditions that (1) the released performance bond amount of \$500,000 shall be paid directly from First Citizens Bank to the DLNR within 30 days of the Board's approval; and (2) in the event the Lessee violates any term or condition of the Lease in the future, then the Chairperson may, with 30 days written notice, require that the full performance bond (two times the annual rent) be posted. The failure to timely post the required bond shall be deemed a material default and the State may terminate the Lease and pursue all other rights and remedies it may have. A copy of this submittal will be provided to First Citizens Bank when the matter is

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<sup>3</sup> A separate improvement bond in the residual amount of \$211,000 in favor of DLNR covering the Mauna Kea Tower further protects the improvements and leasehold estate against the contractor's claim.


<sup>4</sup> Nevertheless, staff has brought the complaints about the land, including stagnant water in the swimming pool, accumulation of green waste, and the dilapidated condition of the restaurant to Lessee's attention. Lessee indicates that it is undertaking efforts to clean up the property and repaint the salvageable structures in the next few months. The main restaurant facility will likely have to be demolished. However, Lessee would need a longer term lease from the private owner to justify a major demolition and improvement project.

confirmed on the agenda.

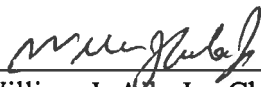
RECOMMENDATION: That the Board reduce the performance bond requirement for General Lease No. S-5844 to an equivalent of six months of rent, further subject to the following:

1. The released performance bond amount of \$500,000 shall be paid directly from First Citizens Bank to the Department of Land and Natural Resources within thirty (30) days of the Board's approval of the reduction of the bond; and
2. In the event the Lessee violates any term or condition of the Lease in the future, then the Chairperson may, with thirty (30) days written notice, require that the full performance bond (two times the annual rent) be posted. The failure to timely post the required bond shall be deemed a material default and the State may terminate the Lease and pursue all other rights and remedies it may have.

Respectfully Submitted,

  
for Kevin E. Moore  
District Land Agent

APPROVED FOR SUBMITTAL:

  
William J. Aila Jr., Chairperson

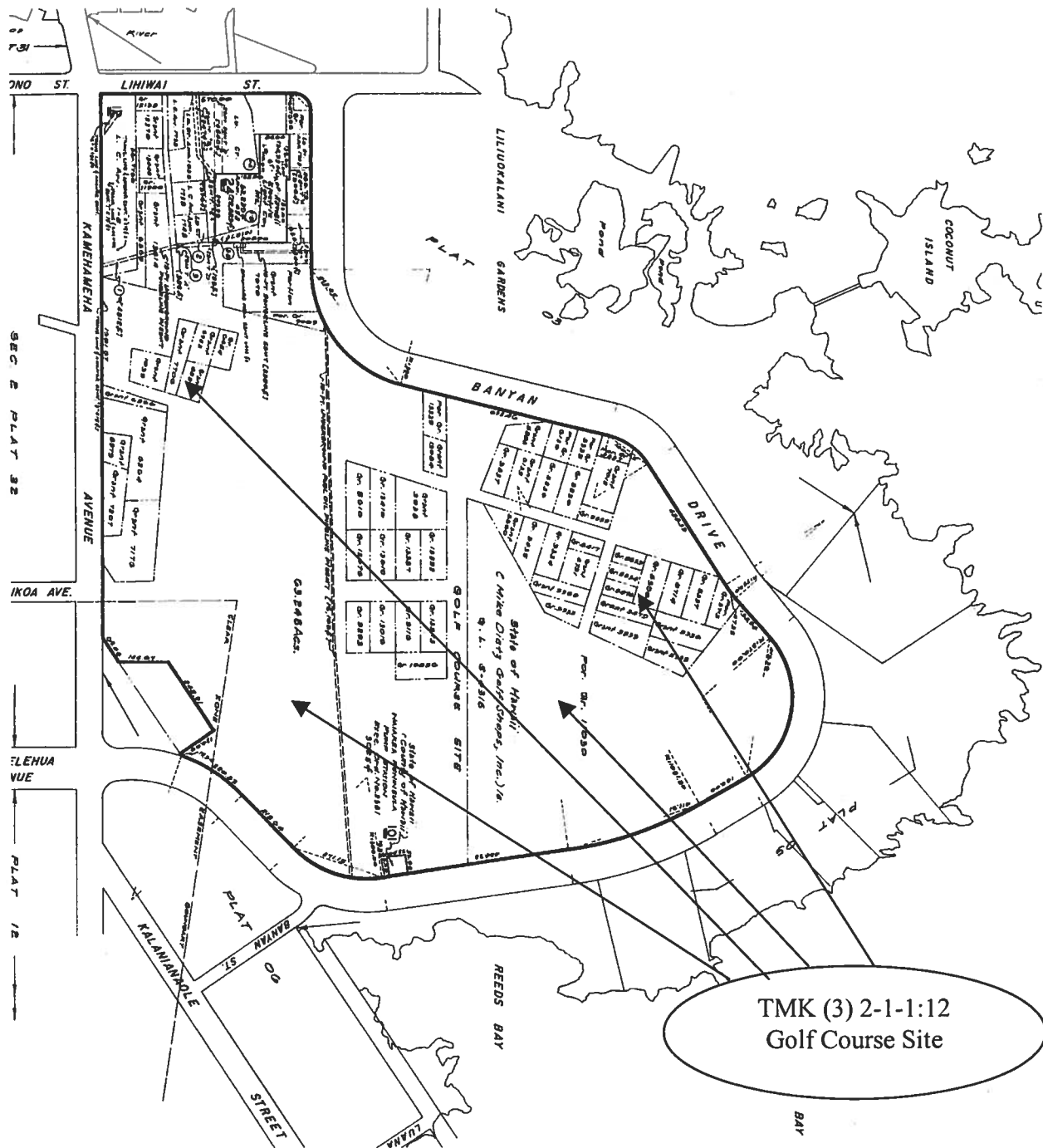
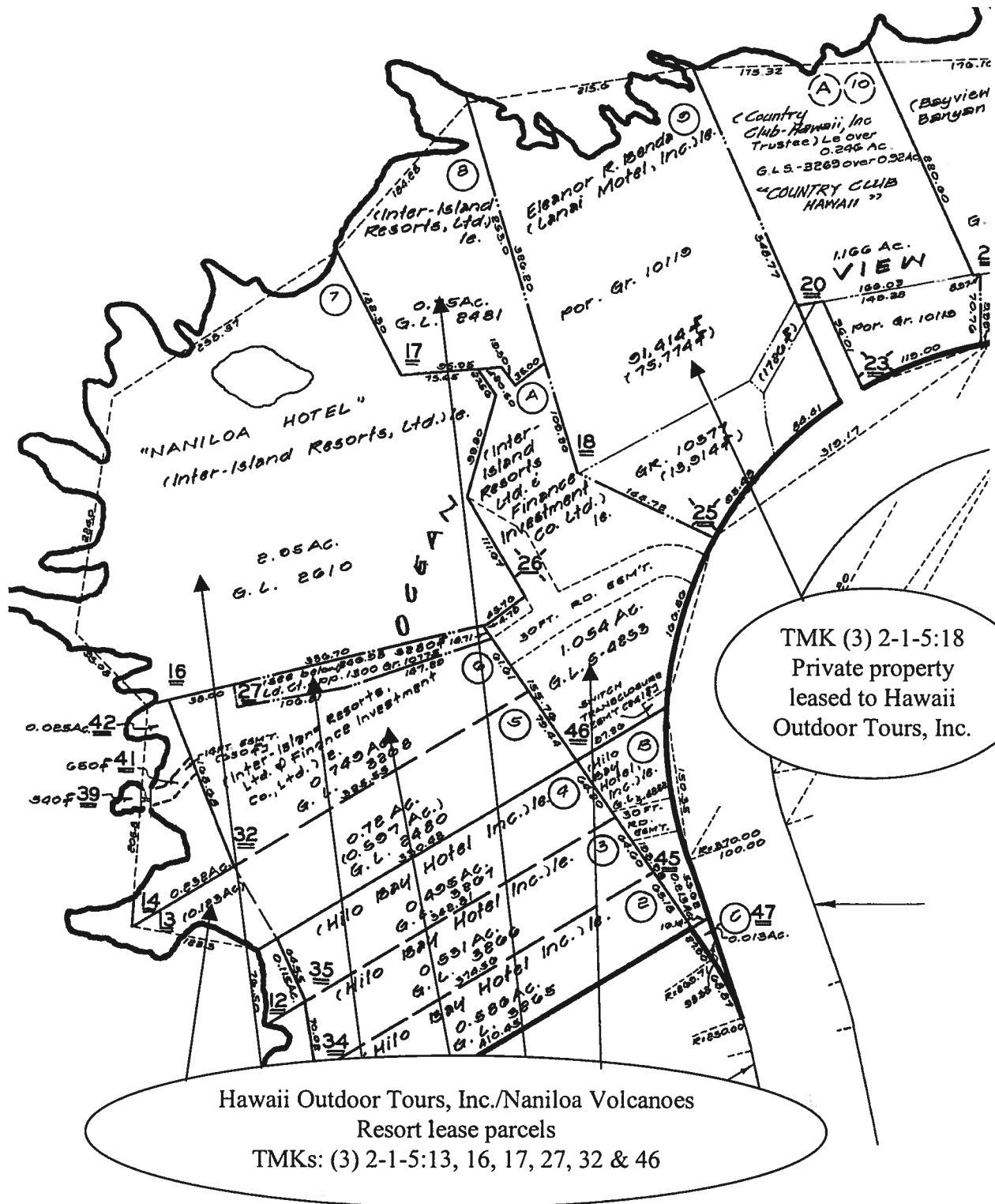


EXHIBIT A





2011 MAR -9 P 3:57

93 Banyan Drive, Hilo, Hawaii 96720  
Phone: 808.969.3333 Fax: 808.969.6622 Web: www.hottours.us

RECEIVED  
LAND DIVISION  
HILO, HAWAII

March 9, 2011

Mr. Russell Y. Tsuji  
Administrator, Land Division  
Department of Land and Natural Resources  
Kalanimoku Building  
1151 Punchbowl Street, Room 220  
Honolulu, Hawaii 96813

**RE: Hawaii Outdoor Tours, Inc.  
General Lease No. S-5844**

Dear Mr. Tsuji:

Hawaii Outdoor Tours, Inc. ("Lessee") operates the Naniloa Volcanoes Resort located at 93 Banyan Drive, Hilo, Hawaii under General Lease No. S-5844 dated January 20, 2006 (the "Lease") with the State of Hawaii (the "State"). We are writing this letter to request a reduction in the performance bond amount required under the Lease from an amount equal to two times the annual rent (currently equal to \$1,000,000), to an amount equal to the one time annual lease rent or \$500,000.

#### **A. BACKGROUND**

The Lease is a ground lease for a term of 65 years, with an expiration date of January 31, 2077, for property situated at Waiakea, South Hilo, Island of Hawaii, containing an area of approximately 6.35 acres ("Resort Site") and 63.775 acres ("Golf Course and Allied Facilities Site"). The properties are improved and contain a hotel ("Naniloa Volcanoes Resort") and golf course ("Naniloa Volcanoes Resort Golf Course"), respectively. The current annual rent is \$500,000 paid semi-annually on February 1<sup>st</sup> and August 1<sup>st</sup> of each year.

Lessee has been the lessee since February 2, 2006. Lessee's leasehold interest is encumbered by a mortgage (the "Mortgage") in favor of First Citizens Bank (the "Mortgagee"). First Citizens Bank took over First Regional Bank, the original Mortgagee. Consent to the Mortgage was given by the State.

**EXHIBIT B**

Since becoming Lessee under the Lease, Lessee has paid all rentals to the State. Lessee has also maintained property in good condition and repair, has addressed all

necessary improvements on a timely basis and otherwise has complied with all applicable terms and conditions of the Lease.

Mr. Kenneth Fujiyama is the CEO of the Lessee and the CEO of the entities that currently run the botanical gardens known as Nani Mau Gardens and formerly ran the Volcano House. Lessee has been and continues to be a responsible owner who contributes to the State's economy and fulfills its contractual obligations.

## **B. BOND REQUIREMENT UNDER THE LEASE**

Section 18 of the Lease requires Lessee to post a bond in an amount equal to two times the annual rent then payable to ensure the full and faithful observance and performance by the Lessee of all the terms, conditions, covenants, and agreements of the Lease. The current amount of bond being posted by Lessee is \$1,000,000 in cash through a savings account with First Citizens Bank in Southern California.

Section 28 of the Lease states that "Upon substantial compliance by the Lessee of the terms, covenants, and conditions contained in this lease on its part to be observed or performed, the Lessor at its discretion may in writing, waive or suspend the performance bond and /or improvement bond requirements or may, in writing, modify the particular bond(s) or liability insurance requirements by reducing its amount; provided, however, that the Lessor reserves the right to reactivate the bonds or reimpose the bond(s) and/or liability insurance in and to their original tenor and form at any time throughout the term of this lease."

## **C. BASIS OF REQUEST FOR A REDUCTION IN THE BOND AMOUNT**

Lessee hereby requests a reduction in the bond amount required under the Lease from an amount equal to two times the annual rent (currently equal to \$1,000,000), to an amount equal to one year's rent (currently equal to \$500,000) as the ability to secure credit has become increasingly difficult due to the tightening of the credit markets and financial institutions' reluctance to advance credit for operations and construction.

Hawaii Outdoor Tours, Inc. will apply the \$500,000 reduction of bond amount which is held in cash for the full 2011 lease rent.

## **D. LESSEE'S PROPOSAL FOR REDUCTION IN BOND REQUIREMENT**

Lessee submits that the cash deposit of \$500,000 is more than adequate to protect the State in the event of a default for the reasons listed below.

1. **Naniloa Volcanoes Resort Improvements.** In the event of a default under the Lease the Board of Land and Natural Resources has the right to terminate the Lease and take possession of the Property after proper notification has been given. In such event, the State would receive the property improved with an operating hotel that is in good condition. Since becoming Lessee, Lessee has renovated 175 out of 178 rooms in the Mauna Kea Tower and renovated 91 out of 142 rooms in the Mauna Loa Tower. Lessee has also renovated the interiors of the Polynesian Room and Sandlewood Dining Room plus the swimming pool. The Lessee has also completed about 70% of the remodeling work for the Kilauea Tower which includes 64 rooms,



Section 40 of the Lease required the Lessee to complete or install \$5,000,000 of renovations or FF&E to the existing hotel within three (3) years after the commencement date of the lease (or February 2009) which it did. As of December 2010 Hawaii Outdoor Tours, Inc. has expanded approximately \$7,900,000 in renovation work and FF&E.

It should be noted that construction work and soft cost was done with Ken Fujiyama as the general contractor and designer (License BC-7100) using only 5% mark up for all cost including overhead above actual purchases which invariably kept the cost well below using an outside contractor and designers / architects.

2. **Lender's Interest in Curing Lessee Defaults.** As noted above, Lessee's interest is encumbered by the Mortgage in favor of the Mortgagee. In the event of a Lessee default, the State is also required under the Lease and by state to provide notice of such default to the Mortgagee. The mortgagee has a vested interest in curing any such default prior to the State instituting any Lease forfeiture action given that the Lease is the Mortgagee's collateral.

Traditionally, lenders have been willing to satisfy the lease requirements of the borrower/lessee where the borrower/lessee has defaulted in its obligations under a lease where the lender's collateral is at stake. This should give the State additional comfort that any default by Lessee will not go uncured.

3. **Increase in Occupancy Projections.** Wholesalers are starting to rebook rooms with Naniloa Volcanoes Resort since a major portion of the rooms have been remodeled and since construction has been limited in scope. The announcement of direct mainland flights from Los Angeles and San Francisco starting on June 9<sup>th</sup> by Continental / United Airlines also improves the projected occupancy.
4. **Ken Direction Corp. (KDC) Operational Plan.** The operational plan of the Lessee's parent company includes:

- a. Lessee will apply the \$500,000 from the bond reduction against this year's rent. This action will prevent a default for this year and will give Lessee time to accomplish other aspects of its operational plan.
- b. Lessee has been working with First Citizens Bank to rollover its construction loan since long term financing has not been available for the past couple of years.
- c. KDC subsidiary has a land contract for sale to a private party.
- d. KDC has a contract for sale with the National Park Service. The closing of this contract has been delayed due to the non-approval of the Federal Budget since October 2010.

Once obtained, the above actions will help with financing for the future construction phases of the Naniloa.

In conclusion, the Lessee requests that the State allow a reduction in the performance bond requirement in the Lease from an amount equal to two times the annual rent to an amount equal to one annual payment. Lessee submits that even with this reduction in the bond amount, the State will continue to be adequately protected.

Thank you for your consideration of this matter. Should you have any questions or require additional information, please do not hesitate to call Kenneth Fujiyama at

Very truly yours,  
Hawaii Outdoor Tours, Inc.

A handwritten signature in black ink, appearing to read 'Kenneth Fujiyama', with a large, stylized initial 'K'.

Kenneth Fujiyama, CEO